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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-227

FEDERAL POWER COMMISSION, *Petitioner*
v.
CONSUMER FEDERATION OF AMERICA, ET AL.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF TEXAS GAS TRANSMISSION CORPORATION AND TRANSCONTINENTAL GAS PIPE LINE CORPORATION IN CONDITIONAL SUPPORT

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BRIEF OF TEXAS GAS TRANSMISSION CORPORATION AND TRANSCONTINENTAL GAS PIPE LINE CORPORATION IN CONDITIONAL SUPPORT

Texas Gas Transmission Corporation (Texas Gas) and Transcontinental Gas Pipe Line Corporation (Transco), parties to the proceedings in the court below, hereby submit this brief in conditional support of Petitioner.

TEXAS GAS AND TRANSCO

Texas Gas is a corporation organized and existing under the laws of the State of Delaware. It is a natural gas company as defined in Section 1(b) of the Natural Gas Act and, as such, is engaged in the business of transporting and selling natural gas in interstate commerce under authorizations granted by the Commission. The facilities operated by Texas Gas, as a natural gas company, consist primarily of a pipeline system located in Texas, onshore and offshore Louisiana, Arkansas, Mississippi, Tennessee, Kentucky, Indiana, Illinois and Ohio.

Transco is a corporation organized and existing under the laws of the State of Delaware. It is a natural gas company as defined in Section 1(b) of the Natural Gas Act and, as such, is engaged in the transportation and sale of natural gas in interstate commerce by means of its natural gas transmission system extending from its sources of gas supply in Texas, Louisiana and Mississippi through the States of Alabama, Georgia, South Carolina, Virginia, Maryland, Pennsylvania and New Jersey to its termini in the Metropolitan New York area.

Both Texas Gas and Transco fully participated as intervenors in the proceedings before the court of appeals.

QUESTIONS PRESENTED

1. Whether the Commission possesses the legal power under Sections 7(c) and 16 of the Natural Gas Act, 15 U.S.C. 717f(c), 717o, to exempt, from rate and certificate regulation, short-term emergency sales of natural gas that would otherwise be sold in the intrastate market in order to forestall the

rapidly decreasing supplies of natural gas available to the interstate market and the concomitant increase in interstate pipeline curtailments of high-priority markets?

2. If not, may the Commission exempt such sales from rate and certificate regulation by indirectly regulating such rates in rate proceedings of the purchasing pipelines: (a) when the pipelines "are given no guidance whatsoever as to what the standards may be" *(FPC* v. *Texaco Inc.)* and (b) when the exemption will be counter-productive since neither the pipeline nor the producer will enter into such transactions under these circumstances?

STATEMENT

A. Background

Section 7(c) of the Natural Gas Act, as amended, provides that the Commission "may by regulation exempt from the requirements of this section temporary acts or operations for which the issuance of a certificate will not be required in the public interest." Pursuant to that enabling provision, the Commission's Regulations have, for many years, provided for exemption of temporary acts and operations by natural gas companies from certain certification requirements of the Act. The term "temporary acts or operations" was consistently interpreted as including sales in interstate commerce by producers to pipelines for resale. Prior to the issuance of Order No. 491, *et seq.* (FPC Pet., pp. 33a-109a), however, such exemptions were available only where the acts or operations were limited to a period of not more than 60 days. Order No.

491 extended the period during which the emergency sections could be invoked to 180 days.

Recently, the exemption provisions have been increasingly utilized on a widespread basis due to the nationwide natural gas shortage. Pipelines experiencing gas supply emergencies have made "spot" purchases for the 60 or 180 day exemption period in order to supplement dwindling reserves. Under Section 2.68 of the Commission's Regulations, distribution companies have also engaged in exempt 60 day sales among themselves. In addition, pipelines have contracted for "limited-term" purchases pursuant to Order No. 431, 45 FPC 570 (1971), by which producers apply for limited-term certificates (generally for 1 to 2 year periods), with pre-granted abandonment, for sales at rates in excess of the "just and reasonable" ceiling then applicable to long-term sales in the Commission pricing area in question. Although these prices were higher than the appropriate "just and reasonable" rates, these rates became *legal* rates which the pipelines were authorized to pay without exposure to later disallowance of any portion of such expenses from their costs of service.

The severe shortage of natural gas has intensified the competition for available long-term and short-term supplies. Pipelines are attempting to attract gas away from the unregulated intrastate market. It is common knowledge, however, that prices in the intrastate market are at least two or three times the price set by the Commission for interstate sales. In order to secure gas that would otherwise be sold in the unregulated intrastate market at prices in excess of federally-controlled rates, the Commission, through its exemption regulations, relieved producers from the constraint of area rate ceilings in the hope that interstate pipelines would thereby be able to compete effectively with intrastate purchasers for such scarce supplies. It is in this context, then, that the Order No. 491 series must be considered.

B. Proceedings Before the Commission

On September 14, 1973, the Commission issued Order No. 491 (FPC Pet., pp. 33a-41a) which extended from 60 days to 180 days the period of time that a pipeline experiencing a system shortage could make emergency purchases of natural gas absent Commission certification under Section 7(c) of the Act. The order was designed to avert significant economic and social dislocations that would result from the severe supply deficiency projected for the 1973-1974 winter season. The amendments were to expire at the conclusion of the winter season on March 15, 1974.

The Commission, in Order No. 491-A (FPC Pet., pp. 42a-75a) dated September 25, 1973, denied motions for stay of Order No. 491 and reiterated the necessity of extending the emergency regulations in order to augment the available gas supply for the interstate market during the critical heating season. However, the Commission also indicated *for the first time* that "[t]he rate at which these emergency volumes are committed to interstate pipelines will be examined in our pipeline regulatory review under Sections 4 and 5 of the Act, in the same manner as purchases are reviewed under the prior emergency procedures."[1] (FPC Pet., p. 52a)

[1] While the Commission's statement implies that emergency purchases had previously been reviewed by the Commission in the same manner as here proposed, neither Texas Gas nor Transco had any prior knowledge of any such review of emergency purchases or, for that matter, any prior hint that such "indirect" review was ever contemplated or intended by the Commission.

In response to written comments filed by various parties, the Commission issued Order No. 491-B (FPC Pet., pp. 76a-104a) on November 2, 1973, and again reaffirmed its policy of permitting 180 day emergency sales. The Commission amplified its position with respect to "indirect" review of emergency sales in the following manner:

> "As we indicated in Order No. 491-A (*mimeo* at 8), we will scrutinize the rates of all emergency purchases in the review of purchased gas costs in pipeline rate proceedings, including purchased gas [footnote omitted] adjustment clause increases. We will permit the pipeline to pass on to the consumer the rates of emergency purchases *only* when such rates can be shown to have been required by the public interest." (Emphasis in original.) (FPC Pet., p. 91a)
>
> * * *
>
> "Should we determine in a pipeline rate case that any emergency purchase was improvidently consummated at a rate which was more than necessary to secure the gas for the interstate market, we will not require refunds by the producer." (FPC Pet., p. 92a)

The Commission denied rehearing and stay on November 21, 1973, in Order No. 491-C (FPC Pet., pp. 105a-109a). Pursuant to applications for stay filed by interested parties, the court of appeals granted a stay of the Commission's orders on December 10, 1973. The stay, however, was later vacated by this Court on December 20, 1973 (414 U.S. 1117).

C. The Decision Below

The court of appeals determined that the action taken by the Commission was outside the scope of its authority under Section 7(c) of the Act and, thus, set

aside the orders (FPC Pet., pp. 1a-30a). In analyzing the legislative history and the purpose of Section 7, the court concluded that the exemption proviso contained therein did not enable the Commission to exclude the short-term emergency sales authorized in Order No. 491 from the certification process.

Citing *FPC* v. *Texaco Inc.,* 417 U.S. 380 (1974), the court below held that the Commission's orders did not constitute a valid means of *indirect* regulation because there was no assurance that the rates "paid by pipelines" (FPC Pet., p. 22a) to producers would be just and reasonable. The court also indicated that the standard for indirect regulation did not guarantee, as required by its reading of *Texaco,* that "the rates 'ultimately borne by the consumer are just and reasonable.' " (FPC Pet. p. 25a)

The indirect regulatory scheme was further deemed inadequate for its failure to articulate standards to guide pipelines in contracting for emergency purchases. As the court noted:

> "In *Texaco* the Court was concerned with the *squeeze on the pipelines* which stemmed from making payments that would be both disallowed and nonrefundable, and made it clear that any such program would require *'guidance'* for those that might be affected. [footnote omitted] *The warning in Order 491 against 'improvident' contracts does not provide adequate guidance to protect the pipelines."* (Emphasis added.) (FPC Pet., p. 26a)

D. Commission Action Subsequent to Order No. 491

Because of the uncertainty surrounding the validity of the 180 day exemption, the Commission terminated the program on March 15, 1974. However, the Com-

mission has continued to recognize the need for attracting intrastate supplies into the interstate market. First, it sought and obtained an expedited decision in this case from the court below in a vain effort thus far to reinstitute the 180 day exemption. Second, the Commission recently (August 28, 1975) promulgated Order No. 533 which announced the Commission's willingness to certificate transportation arrangements by interstate pipelines on behalf of their high-priority industrial customers. The purpose of such policy is to allow industrial users to purchase gas *directly* from producers *at prevailing market prices* and, therefore, to "compete with the producer's intrastate customers for gas supplies not otherwise available to the interstate market." The Commission's rate jurisdiction would not attach to such direct sales because Section 1(b) of the Act only authorizes the Commission to regulate *sales for resale.*

On June 17, 1975, the Commission issued the first of a series of orders (see, e.g., *Texas Gas Transmission Corporation*, Docket No. RP74-25, *et al.*) concerning the 180 day purchases made by interstate pipelines pursuant to Order No. 491. The various orders set procedural schedules for the convening of public hearings so that the producer and the pipeline could justify the justness and reasonableness of the rates for all emergency sales consummated in excess of the 51-cent nationwide rate. Despite the fact that the Commission did not list any meaningful standards in Order No. 491 to guide pipelines in contracting for emergency purchases, these later orders compelled the submission of evidence pertaining to, *inter alia,* the producer's individual costs, the pipeline's need for the gas and the availability of other gas supplies (see p. 15, *infra*).

THE POSITION OF TEXAS GAS AND TRANSCO

Texas Gas and Transco are fully in accord with the Commission's announced intention of securing additional gas for the interstate market by means of its emergency regulations. However, it is unnecessary and, in fact, unlawful to uphold the validity of the emergency provisions on the basis of indirectly regulating the producer prices at the pipeline level. We support the Commission's petition for a writ of certiorari but only to the extent that the emergency exemption is permissible without a subsequent rate review at the pipeline level.

Inasmuch as there were no standards prescribed in Order No. 491 to guide pipelines in making emergency purchases, it seems clear under *Texaco, supra,* that the same defects are present in Order No. 491 as in that case. A contrary conclusion would entail the retroactive imposition of *ex post facto* Commission guidelines. The court below, as did this Court in *Texaco,* perceptively took cognizance of the unlawful "squeeze" on the pipelines resulting from the lack of adequate standards (FPC Pet., p. 26a).

The major thrust of our participation in the instant case, however, is directed to the legal parameters which must circumscribe future Commission actions involving emergency interstate sales. If properly enacted, such future regulations will provide a viable means for interstate pipelines to alleviate their serious supply deficiences. We believe that the Commission possesses the requisite authority under the Natural Gas Act to exempt short-term emergency sales to curtailing interstate pipeline companies from rate and certificate jurisdiction.

We submit that the prevailing ("in line") market price provides the only appropriate test to be used in satisfying the requirements of the Natural Gas Act in making the 180-day exemption a viable vehicle for the acquisition of additional interstate gas. It must be remembered that the emergency provisions were adopted by the Commission to procure gas *not otherwise available to the interstate market.* If a producer has the option of selling its gas in the unregulated intrastate market, the only relevant consideration should be, as far as the Commission is concerned, the determination of the price required to entice the producer to sell his gas in the interstate market. The choice for interstate pipelines, and the interstate market in general, is not between gas priced at one level vs. gas priced at a different level but rather *gas priced at the prevailing market level* vs. *no gas at all.* Emergency provisions not attuned to this fact of life will only ensure that essentially all onshore gas will continue to be sold in the intrastate market.

ARGUMENT

A. The Commission Has the Legal Power To Exempt Short-Term Interstate Sales of Natural Gas from Rate and Certificate Regulation During Periods of Emergency.

The exemptive authority contained in Section 7(c) of the Act affords a proper legal foundation for Commission suspension of rate and certificate jurisdiction with respect to *short-term* emergency sales of natural gas. Confronted with an acute shortage of new supplies and rapidly escalating curtailments of high-priority markets by interstate pipelines, the Commission has resorted to extraordinary, and yet necessary, measures to cope with this crisis. The powers of the Commission in this area, therefore, must be generously

construed to enable the Commission to fulfill its pressing responsibilities under the Act. *Permian Basin Area Rate Cases,* 390 U.S. 747, 776 (1968).

In order to attempt to maintain adequate service to existing interstate consumers, the Commission is certainly justified in exempting emergency sales on a *temporary* basis. Unlike *Texaco,* which involved the *permanent* certification of small producer sales, the emergency provisions contemplate transactions of a *short-term* nature only and, hence, fall within the confines of the exemption proviso in Section 7(c).

B. The Prevailing Market Price Provides an Appropriate Standard that Fully Satisfies the Dictates of the Natural Gas Act.

As conceived by the Commission, the principal purpose of Order No. 491, and presumably of any future emergency regulation, was to secure, for the interstate market, gas that would not otherwise be available to interstate consumers. In pursuit of this laudatory goal, the Commission authorized and, indeed, encouraged interstate pipelines to compete with prospective intrastate purchasers for reserves that would ordinarily be sold in the intrastate market. We cannot overemphasize the very basic maxim that, unless interstate pipelines are able and willing to offer a price competitive with the existing rate in the intrastate market, the gas will not be obtained. Indeed, the whole point in the Commission's issuance of Order 491 was to free the pipelines from the price constraints of existing area ceilings. Otherwise, there would have been no purpose in the issuance of such an order. This fact was recognized by the court below:

> "The entire point of Order 491 is to free 'pipelines facing emergencies' from price constraints to 'en-

able them to secure substantial gas supplies which might otherwise be lost to the intrastate market or interstate pipelines not facing an emergency.'" (Footnote omitted.) (FPC Pet., p. 25a)

Given this simple fact of life and coupled with an *interstate* gas shortage of enormous proportions, we submit that a rate that is first, "in-line" (*CATCO, infra*) with prevailing market prices, and second, able to elicit the additional supplies, satisfies the requirements of the Act for short-term emergency purchases. To hold otherwise would be to engage in the naive notion that the Commission must establish a rate for short-term onshore sales at a level *beneath* the prevailing market price. The Commission would then be establishing a rate at which *not* one additional cubic foot of gas would be sold in the interstate market. It is inconceivable that regulation of this type produces any benefits whatsoever for high-priority interstate customers desperate for new sources of natural gas.

Inasmuch as *Texaco* dealt with small producer sales of *permanent* duration, this Court's admonition that "all gas rates [must] be just and reasonable" would not appear to be applicable to the *temporary* emergency sales discussed herein.[2] In *Atlantic Refining Co.* v. *Public Service Commission of the State of New York* (CATCO), 360 U.S. 378 (1959), for instance, this Court stated that the Act does not compel a determination of just and reasonable rates for *initial* sales made pursuant to a certificate issued under Section 7(c).

[2] Even if the rates for emergency sales have to be "just and reasonable", the prevailing market price standard would still be applicable because it is the only standard that will elicit *any* onshore supplies away from the unregulated intrastate market and, therefore, under such circumstances, the "prevailing market price" must be considered as the "just and reasonable" rate.

Thus, the rates paid by pipelines for emergency purchases should be adjudged excessive only in the event that such rates are "out of line" with prevailing prices in the area. *See CATCO,* 360 U.S. at 391.[3] Only the "in-line" prevailing market price standard will ensure compliance with the appropriate statutory requirement and, at the same time, provide a means of acquiring the sorely needed gas supplies for the interstate market. Therefore, we urge this Court to approve utilization of such standard in the Commission's determination of the propriety of the rates agreed to by interstate pipelines and producers in connection with emergency sales.

C. Contrary to This Court's Decision in Texaco, Order No. 491 Provided Absolutely No Standards To Guide Pipelines in Making Emergency Purchases.

The court of appeals rightly concluded, pursuant to the doctrine espoused in *Texaco,* that Order No. 491 unlawfully neglected to establish standards by which pipelines could be guided in the consummation of em-

[3] It is interesting to note that while the court below placed considerable emphasis on *CATCO* in reversing Order No. 491, certain significant factors upon which the 1959 decision was premised are no longer valid today: (1) the pipeline had not demonstrated a need for the gas; (2) the producers had not shown the availability of the intrastate market as an outlet for their gas; and, (3) the sales would only have been profitable in the interstate market where 90% of all gas was then being sold. 360 U.S. at 393-394. In contrast, in 1973 production for interstate use represented less than 63% of total production in the lower 48 states. More importantly, in the most recent four years for which data are available (1970-1973), interstate pipelines have acquired only about 8% of national reserve additions, including offshore reserves, which demonstrates vividly the inability of interstate pipelines to compete for market priced intrastate supplies. Source: FPC Staff Report: "A Realistic View of U.S. Natural Gas Supply," December, 1974.

ergency sales contracts. As the court below aptly remarked:

> "A related shortcoming is the Commission's failure to provide pipelines with standards to guide them in latitude contemplated in contracting for emergency purchases. Under Order 491, if pipelines pay too much for gas supplies, they may incur expenses that are nonrefundable. In *Texaco* the Court was concerned with the *squeeze on the pipelines* which stemmed from making payments that would be both disallowed and nonrefundable, and made it clear that any such program would require 'guidance' for those that might be affected. The warning in Order 491 against 'improvident' contracts does not provide adequate guidance to protect the pipelines. The Commission attempts to avoid this problem by stating that the procedures are 'purely optional' and that the order does not 'coerce a pipeline into making such purchases.' But a commission seeking to defend an exemption order cannot in this way ignore its responsibility to give guidance to pipelines that accept the Commission's open-door invitation to obtain needed supplies through Order 491 purchases." (Footnotes omitted.) (Emphasis added.) (FPC Pet., p. 26a)

Since the requisite standards are missing, the Commission should be precluded from denying in a pipeline's cost of service any amounts paid to producers with respect to emergency sales which are required to obtain the gas for the interstate market. Otherwise, interstate pipelines will be held accountable, unjustifiably, for emergency purchases on the basis of retroactively applied standards.

Although Order No. 491 terminated on March 15, 1974, it was not until June 17, 1975, in *Texas Gas Transmission Corporation,* Docket No. RP74-25, *et al.,* that the Commission first suggested criteria that would be used to evaluate the prices paid for emergency gas. The injection of such *ex post facto* standards into pipeline rate proceedings involving Order No. 491 transactions is patently at odds with the most basic due process considerations. Because these standards might be employed in the future, however, it is appropriate to set forth the Commission's statement regarding the evidence that must be furnished in these proceedings. In *Texas Gas Transmission Corporation,* for example, the Commission ordered the following data to be submitted:

> "Cost evidence relating to the producer sales under Order No. 491 can clearly provide the basis for 'just and reasonable' rate findings. *F.P.C.* v. *Texaco Inc.,* 417 U.S. 380 (1974). It follows then, that the producer should introduce relevant evidence of the cost involved in its sale. Such evidence shall be considered together with all other material evidence which would support a finding of a just and reasonable rate in excess of the national rate [51 cents per Mcf].
>
> The cost evidence submitted by the producer should include, *inter alia,* the direct and indirect costs, including the cost of all capital funds reasonably allocated to its sale. In addition, the producer should indicate the price for which the subject gas is now being sold, whether in intrastate or interstate commerce.
>
> The pipeline should submit evidence as to (1) its need for the gas, (2) the availability of other gas supplies, (3) the amount of gas purchased from the producer involved under the emergency provisions of Order No. 491, as amended, (4) the rates of other producer sales under Order No. 491

approved for flow through, and (5) the prevailing prices in the area for both interstate and intrastate sales of gas."

The above-mentioned "guidelines" are hopelessly vague; there is no indication as to the relative weight to be accorded to the various pieces of evidence. Given these imprecise guidelines, the risk of possible Commission disallowance of prudently incurred purchased gas costs is too severe and will undoubtedly deter the pipeline and the producer from executing a contract for the scarce supplies.

It is evident that the criteria suggested in *Texas Gas Transmission Corporation, supra,* are counter-productive. They will discourage producers as well as pipelines from entering into emergency sales agreements. Moreover, the Commission has given no indication of whether, in the event that excess charges are determined, the producer will be required to make refunds or the pipeline will be required to absorb costs already incurred. In either event, under today's conditions, no substantial amounts of emergency gas would be made available. Either the producers will refuse to sell the gas because of the risk of refunds and the ability to sell the gas intrastate with no risk, or the pipeline will refuse to buy the gas because of the potentially enormous risk of cost absorption to its stockholders.

The Texas Gas case provides ample support for our contention that emergency regulations cannot properly be administered pursuant to the guidelines announced therein. In such proceeding, six producers were required to submit voluminous cost data to justify emergency rates in excess of the 51-cent nationwide ceiling.

The total amount of money in question was $21,263; in fact, two of the producers collected revenues of only $462 and $527 above the revenues for comparable volumes priced at the national rate and, yet, were still expected to file the evidence, come to Washington, D. C. for the hearing, and furnish supporting witnesses. To forestall such unnecessary expense and obvious waste of time, Texas Gas reluctantly expressed its willingness to absorb the $21,263 in its rates and, therefore, moved to terminate the proceeding.

A decision by this Court authorizing emergency provisions to operate in the manner suggested by the Commission would result in the classic example of a Pyrrhic victory. The Commission would then issue new emergency regulations encompassing the *Texas Gas* standards—standards under which neither producers nor pipelines would be willing to participate.

CONCLUSION

It is unfortunate that the Commission has not faced the reality that only competitive market prices will elicit emergency supplies for the interstate market and then only if the purchasing pipelines are assured of passing on these prices to their customers. Given the posture in which the Commission presents its petition, i.e., that the prices will be "just and reasonable" under the vague criteria suggested by the Commission, the grant of certiorari and reversal of the court below would not only be clearly contrary to this Court's decision in *Texaco, supra,* but, in addition, would accomplish little, if anything, toward the acquisition of additional gas for the interstate market. However, if the Court is inclined to consider not only the question of Commission power to exempt for 180 day emergencies

but also the question of authority to permit sales and purchases of such gas at market price levels, Texas Gas and Transco would support the grant of certiorari.

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